No. 18-459

IN THE

Supreme Court of the United States

EMULEX CORPORATION, ET AL.,
Petitioners,

v.

GARY VARJABEDIAN AND JERRY MUTZA,
Respondents.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

BRIEF OF THE SECURITIES INDUSTRY AND FINANCIAL MARKETS ASSOCIATION AS *AMICUS CURIAE* IN SUPPORT OF PETITIONERS

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TABLE OF CONTENTS

TABLE OF AUTHORITIES IV

INTEREST OF AMICUS CURIAE 1

INTRODUCTION AND SUMMARY OF ARGUMENT 2

ARGUMENT 5

I. THE NINTH CIRCUIT ERRED BY ADOPTING A NEGLIGENCE STANDARD FOR SHAREHOLDER CLAIMS UNDER § 14(e) OF THE EXCHANGE ACT. 6

A. The Ninth Circuit's Negligence Standard Is Inconsistent with the Plain Text of the Statute 6

B. Congressional Intent Confirms That § 14(e) Claims Require Scienter. 10

II. A NEGLIGENCE STANDARD WILL FURTHER ENCOURAGE AND FEDERALIZE MERGER OBJECTION LITIGATION. 11

A. *Trulia* Eliminates Delaware as a Friendly Forum for Merger Objection Suits. 14

B. The Plaintiffs' Bar Shifts Merger Objection Suits to Federal Court. 16

C. The Plaintiffs' Bar Forum Shops Within the Federal Court System. 18

III. OTHER POLICY CONSIDERATIONS STRONGLY FAVOR A SCIENTER STANDARD FOR § 14(e) CLAIMS. 19

A. A Negligence Standard for § 14(e) Increases the Risk of Over-Disclosure..... 19

B. A Negligence Standard for § 14(e) Violations Will Chill Tender Offers..... 22

C. A Negligence Standard for § 14(e) Undercuts Settled Mergers and Acquisitions Law. 25

CONCLUSION 28

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432 U.S. 275 (2001) 6

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568 U.S. 455 (2013) 1

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511 U.S. 164 (1994) 28

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571 U.S. 377 (2014) 1

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480 F.2d 341 (2d Cir.), *cert. denied*, 414 U.S. 910 (1973) 7, 10

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583 U.S. ___, 138 S. Ct. 1061 (2018) 1

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357 F.3d 322 (3d Cir. 2004) 6, 7, 20

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563 U.S. 804 (2011) 1

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(E.D. Pa. Apr. 22, 1993),
aff'd, 16 F.3d 403 (3d Cir. 1993) 4, 21

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600 F.2d 355 (2d Cir. 1979) 20

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489 F.2d 579 (5th Cir. 1974) 7, 10

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467 U.S. 822 (1984) 9

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June 30, 2014) 26

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C.A. No. 7197-VCP, 2012 WL 681785 (Del. Ch. Feb. 29, 2012) 22

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INTEREST OF AMICUS CURIAE[1]

The Securities Industry and Financial Markets Association ("SIFMA") is the leading securities industry trade association, representing the interests of more than 650 securities firms, banks, and asset managers. SIFMA's mission is to support a strong financial industry while promoting investor opportunity, capital formation, job creation, economic growth, and trust and confidence in the financial markets. SIFMA works to represent its members' interests locally and globally – it has offices in New York and Washington, D.C. and is the U.S. regional member of the Global Financial Markets Association.

On behalf of the industry's nearly one million employees, SIFMA advocates on issues affecting retail and institutional investors, equity and fixed income markets, and related products and services. To further that mission, SIFMA regularly files *amicus* briefs in cases that raise issues of concern to securities industry participants. *See, e.g.*, *Cyan, Inc. v. Beaver Cty. Emps. Ret. Fund*, 583 U.S. ___, 138 S. Ct. 1061 (2018); *Omnicare, Inc. v. Laborers Dist. Council Constr. Indus. Pension Fund*, 575 U.S. ___, 135 S. Ct. 1318 (2015); *Chadbourne & Parke LLP v. Troice*, 571 U.S. 377 (2014); *Amgen Inc. v. Conn. Ret. Plans & Tr. Funds*, 568 U.S. 455 (2013); *Gabelli v. SEC*, 570 U.S. 254 (2011); *Erica P. John Fund, Inc.*

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[1] All parties consented to the filing of this brief. This brief was not authored in whole or in part by counsel for any party, and no person or entity other than SIFMA, its members, or its counsel made a monetary contribution intended to fund the preparation or submission of this brief.

v. Halliburton Co., 563 U.S. 804 (2011); *Matrixx Initiatives, Inc. v. Siracusano*, 563 U.S. 27 (2011).

The issues raised by this appeal are of vital importance to SIFMA and its members. The plaintiffs-side securities class action bar files lawsuits challenging the vast majority of U.S. public company merger transactions. These "merger objection" suits frequently focus on the financial advice provided to the seller's board of directors – stockholders routinely allege that the financial advisors' analyses were flawed and accompanied by inadequate or incomplete disclosures. The financial analyses targeted in these "merger objection" class actions typically are provided by SIFMA members.

Until recently, stockholders filed most "merger objection" class actions in state court under theories based on state law. Since early 2016, however, and for reasons discussed more fully below, stockholders have changed strategies and now are filing "merger objection" cases in federal court invoking § 14 of the Securities Exchange Act of 1934 (the "Exchange Act"). The appeal here concerns § 14(e), the subsection of the statute governing mergers completed by tender offer. The Ninth Circuit's decision erroneously adopting a negligence standard for § 14(e) claims will, if upheld, have an enormous impact on the mergers and acquisitions industry and especially on financial advisors.

INTRODUCTION AND SUMMARY OF ARGUMENT

The Ninth Circuit incorrectly held that a stockholder asserting a claim under § 14(e) of the Exchange Act is required to plead and prove facts showing that the defendant, in making a false statement or misleading omission in connection with

a tender offer, was merely negligent. This Court should reverse the Ninth Circuit and hold that § 14(e) claims require a showing of scienter – the intent to deceive investors – for several reasons.

First, to reach its conclusion that mere negligence is sufficient to state a claim for money damages under § 14(e), the Ninth Circuit improperly focused on a single clause in the opening sentence of the statute, while ignoring the overall context and structure of § 14(e). As every other court that has addressed the issue over forty years has found, § 14(e) – when the plain text is read in context and as a whole – is an anti-fraud statute that was modeled on Rule 10b-5. In addition to the text of the statute, this conclusion is supported by the congressional record since the adoption of § 14(e), which shows Congress repeatedly chose not to amend § 14(e) to impose a negligence standard after multiple courts interpreted the statute to require scienter.

Second, the Ninth Circuit's negligence standard will encourage and federalize frivolous "merger objection" litigation. The elements of a § 14(e) claim have become critically important given recent developments in the "merger objection" litigation industry. "Merger objection" suits have been around for many decades, but beginning in or around 2000, plaintiffs-side securities class action firms began filing an increasing number of lawsuits challenging the vast majority of public company merger transactions. By 2015, more than 90% of all public company deals were targeted with "merger objection" litigation. The vast majority of these cases were filed in state court, most frequently in Delaware.

In early 2016, however, the Delaware Chancery Court issued the landmark decision *In re Trulia, Inc. Stockholder Litigation*, 129 A.3d 885 (Del. Ch. 2016), which discouraged stockholders from bringing "merger objection" litigation in state court by limiting "disclosure only" settlements (discussed below). To avoid the impact of the *Trulia* decision, stockholders began filing their "merger objection" suits in federal court, relying on § 14 of the Exchange Act. As a result, the number of "merger objection" cases in federal courts has more than doubled since 2016. "Merger objection" litigation has become a federal court and federal law problem that likely will be exacerbated if stockholders can state viable causes of action based on allegations of mere negligence.

Third, other important policy considerations strongly support requiring a scienter standard for claims under § 14(e). For example, the Ninth Circuit's negligence standard creates a substantial risk of over-disclosure. If merger participants can be held personally liable for money damages in multi-billion dollar merger transactions solely on the basis of negligent omissions, merger parties are likely to err on the side of extreme caution and include in already voluminous tender offer documents every potential fact that a stockholder, with the benefit of hindsight, could claim was significant in some way. A negligence standard encourages parties to "bury shareholders in an avalanche of trivial information."[2]

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[2] *In re Goodyear Tire & Rubber Co. Sec. Litig.*, No. CIV. A. 88-8633, 1993 WL 130381, at *6 (E.D. Pa. Apr. 22, 1993), *aff'd*, 16 F.3d 403 (3d Cir. 1993).

Similarly, a negligence standard creates a potential chilling effect on tender offers that are beneficial to the financial markets in general and stockholders in particular. The potential for massive liability arising from an inadvertent omission may cause bidders to refrain from conducting tender offers to replace an entrenched but inefficient management team. A decline in tender offers hurts the market generally and shareholders in particular.

Finally, the Ninth Circuit's adoption of a negligence standard undercuts settled rules in the law of mergers and acquisitions. For example, Delaware law has long held that merger parties must provide stockholders with a "fair summary" of any fairness opinion provided by a financial advisor, while at the same time rejecting claims that seek disclosure of the minutiae and underlying details and assumptions relating to a financial advisor's analysis. The Ninth Circuit's negligence standard creates a strong incentive to disclose every conceivable fact relating to a fairness opinion and not merely a "fair summary."

ARGUMENT

U.S. public companies implement M&A transactions through a variety of legal mechanisms. The mechanism chosen for any particular merger transaction depends on an array of factors, including tax, regulatory, and financial issues. One common structure is the tender offer. In a tender offer, the buyer goes directly to the target's stockholders and offers to purchase their shares, typically at a premium to the prevailing market price. Tender offers may be used in connection with both hostile and friendly mergers. Stockholder disclosures in the tender offer context are governed by state law as well

as federal law, in particular § 14(e) of the Exchange Act and the SEC's rules promulgated thereunder.[3]

Merger transactions are obviously significant events in the life of public companies, posing economic risks for boards of directors, management, employees, stockholders and creditors. Capitalizing on these risks, the plaintiffs-side securities class action bar has developed a litigation strategy designed to extract quick settlements from merger participants by threatening the parties' ability to timely close on agreed transactions, even where the underlying claims lack merit. As explained below, this Court should hold that claims under § 14(e) require scienter because the Ninth Circuit's negligence standard is not supported by the text of § 14(e), case law, congressional intent, or public policy.

I. THE NINTH CIRCUIT ERRED BY ADOPTING A NEGLIGENCE STANDARD FOR SHAREHOLDER CLAIMS UNDER § 14(e) OF THE EXCHANGE ACT.

A. The Ninth Circuit's Negligence Standard Is Inconsistent with the Plain Text of the Statute.

In adopting a negligence standard for § 14(e), the Ninth Circuit expressly acknowledged that it was rejecting past decisions by the Second, Third, Fifth,

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[3] This Court has never held that there is an implied private right of action under § 14(e). The Ninth Circuit assumed that such a private right of action exists without analyzing the issue under *Alexander v. Sandoval*, 532 U.S. 275, 287 (2001). *See* Pet. App. 19a. The Court may reverse the Ninth Circuit for the separate and independent reason that that there is no implied private right of action under § 14(e).

Sixth, and Eleventh Circuits, all of which require scienter as an element of a § 14(e) claim.[4]

The circuits adopting a scienter standard have correctly emphasized the similarities between § 10(b) (15 U.S.C. § 78j), which requires scienter, and § 14(e).[5] In *Chris-Craft Industries*, for example, the Second Circuit stated that although § 14(e) applied to tender offers while § 10(b) applied to the purchase or sale of securities, "the underlying proscription of § 14(e) is virtually identical to . . . Rule 10b-5." 470 F.2d at 362. The following year, the Fifth Circuit also concluded that the elements of a § 14(e) violation and a § 10(b) violation "are identical." *Smallwood*, 489 F.2d at 606.

The Sixth Circuit next adopted a scienter standard for § 14(e). *Adams*, 623 F.2d at 431. There, analyzing the plain language of § 14(e), the Sixth Circuit held that the "language of the Williams Act clearly demonstrations that Congress envisioned scienter" to be required to prove a § 14(e) violation. *Id.*

Over 20 years later, the Third Circuit joined the Second, Fifth, and Sixth, again comparing § 14(e) to § 10(b) and concluding that the two should be

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[4] *See SEC v. Ginsburg*, 362 F.3d 1292, 1297-98 (11th Cir. 2004); *In re Digital Island Sec. Litig.*, 357 F.3d 322, 328 (3d Cir. 2004); *Adams v. Standard Knitting Mills, Inc.*, 623 F.2d 422, 428-29, 431 (6th Cir.), *cert. denied*, 449 U.S. 1067 (1980); *Smallwood v. Pearl Brewing Co.*, 489 F.2d 579, 596, 605 (5th Cir. 1974); *Chris-Craft Indus., Inc. v. Piper Aircraft Corp.*, 480 F.2d 341, 362 (2d Cir.), cert. denied, 414 U.S. 910 (1973).

[5] *See Ginsburg*, 362 F.3d at 1298; *In re Digital Island Sec. Litig.*, 357 F.3d at 328; *Adams*, 623 F.2d at 432; *Smallwood*, 489 F.2d at 596; *Chris-Craft Indus., Inc.*, 480 F.2d at 363-64.

"construed . . . consistently." *In re Digital Island Sec. Litig.*, 357 F.3d at 328. That same year, the Eleventh Circuit adopted a scienter standard. *Ginsburg*, 362 at 1297 ("In order to establish liability under § 10(b) and § 14(e) . . ., the SEC must prove that Ginsburg acted with scienter. . . . ."). And this Court likewise has recognized the similarity between § 10(b) and § 14(e), noting that both are anti-fraud statutes designed to prevent knowing violations of the securities laws. *See Schreiber v. Burlington N., Inc.*, 472 U.S. 1, 10-11 (1985).

The Ninth Circuit rejected the rationale of these courts, instead engaging in a textual analysis of § 14(e) – after assuming the existence of a private right of action – to conclude that negligence is the proper standard. But the Ninth Circuit's analysis is flawed.

In the opinion below, the Ninth Circuit divided § 14(e) into two completely separate parts:

> "It shall be unlawful for any person [1] to make any untrue statement of a material fact or omit to state any material fact necessary in order to make the statement made, in the light of circumstances under which they are made, not misleading, *or* [2] to engage in any fraudulent, deceptive, or manipulative acts or practices, in connection with any tender offer . . . ."

Pet. App. 8a (quoting 15 U.S.C. § 78n(e)) (emphasis and alterations in original). Construing the statute as creating "two different offenses," the Ninth Circuit concluded that "because the text of the first clause of Section 14(e) is devoid of any suggestion that scienter is required, we conclude that the first clause

of Section 14(e) requires a showing of only negligence, not scienter." Pet. App. 8a, 16a.

This analysis, however, violated the principle that courts should not "construe statutory phrases in isolation." *United States v. Morton*, 467 U.S. 822, 828 (1984). Despite the Ninth Circuit's decision to parse § 14(e) into two parts, § 14(e) is a single sentence that includes the language of an anti-fraud provision, including the words "misleading," "fraudulent," "deceptive," and "manipulative." 15 U.S.C. § 78n(e). The Ninth Circuit artificially drew a line between this language and the first portion of § 14(e) without any basis for such a division, and therefore its analysis is wrong.[6]

The Ninth Circuit also ignored Congress's grant of authority to the SEC in the final sentence of § 14(e):

> The Commission shall, for the purposes of this subsection, by rules and regulations define, and prescribe means reasonably designed to prevent, such acts and practices as are fraudulent, deceptive, or manipulative.

15 U.S.C. 78n(e). This regulatory authority provision confirms that Congress intended § 14(e) to serve as an anti-fraud rule.

This Court should reject the Ninth Circuit's negligence standard and instead adopt a scienter

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[6] Moreover, even if the Ninth Circuit were correct in dividing § 14(e) into two clauses, the first clause in no way suggests that *negligence* is required; it says nothing about the mental state necessary to support a claim for making a material false statement.

standard for violations of § 14(e) based on the rationale articulated by the Second, Third, Fifth, Sixth, and Eleventh Circuits.

B. Congressional Intent Confirms That § 14(e) Claims Require Scienter.

The Ninth Circuit also ignored the significance of Congress's decision to leave § 14(e) untouched when enacting the Private Securities Litigation Reform Act of 1995 (the "PSLRA") and the Securities Litigation Uniform Standards Act of 1998 ("SLUSA"). SLUSA, Pub. L. No. 105-353, 112 Stat. 3227 (1998); PSLRA, Pub. L. No. 104-67, 109 Stat. 737 (1995). "Congress is presumed to be aware of an administrative or judicial interpretation of a statute and to adopt that interpretation when it re-enacts a statute without change . . . ." *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Curran*, 456 U.S. 353, 409 n.66 (1982) (quoting *Lorillard v. Pons*, 434 U.S. 575, 580 (1978)).

The Second, Fifth, and Sixth Circuits adopted a scienter standard for § 14(e) prior to the passage of both the PSLRA and SLUSA. In fact, the last of those three decisions was adopted in 1980, fifteen years before the PSLRA was adopted. *See Adams*, 623 F.2d at 428; *Smallwood*, 489 F.2d at 605; *Chris-Craft Indus.*, 480 F.2d at 362. Congress, however, did not revise § 14(e) in connection with either the PSLRA or SLUSA, both of which presented an opportunity to do so. *See, e.g.*, S. Rep. No. 104-98, at 4 (1995) (noting that the purpose of the PSLRA was "to encourage the voluntary disclosure of information by corporate issuers; . . . to empower investors so that they—not their lawyers—exercise primary control over private securities litigation; and . . . to encourage plaintiffs' lawyers to pursue valid claims and defendants to fight abusive claims.").

When passing SLUSA, the Senate Committee on Banking, Housing, and Urban Affairs:

> emphasize[d] that the clear intent in 1995 and our continuing intent in this legislation is that neither the PSLRA nor S. 1260 [the precursor bill to SLUSA] in any way alters the scienter standard in federal securities fraud suits. It was the intent of Congress, as was expressly stated during the legislative debate on the PSLRA, and particularly during the debate on overriding the President's veto, that the PSLRA establish a uniform federal standard on pleading requirements by adopting the pleading standard applied by the Second Circuit Court of Appeals. . . . The Committee emphasizes that neither the PSLRA nor S. 1260 makes any attempt to define that state of mind.

S. Rep. 105-182, at 6 (1998).

Congress's decision to leave § 14(e) untouched – despite the unanimous view at the time that scienter was required to prove a violation of § 14(e) – indicates that Congress viewed scienter as the appropriate standard for state of mind.

II. A NEGLIGENCE STANDARD WILL FURTHER ENCOURAGE AND FEDERALIZE MERGER OBJECTION LITIGATION.

Beginning in or around the early 2000s, "merger objection" litigation started to become a cottage industry, with stockholders challenging an increasing percentage of public company mergers through shareholder class action litigation. *See, e.g.*, Matthew D. Cain et al., *The Shifting Tides of Merger*

Litigation, 71 Vand. L. Rev. 603, 610-11 (2018). The complaints in these "merger objection" cases often are nearly verbatim versions of prior complaints with only the parties' names changed, and they typically are filed within days of the announcement of the mergers. *See* Elliott J. Weiss & Lawrence J. White, *File Early, Then Free Ride: How Delaware Law (Mis)shapes Shareholder Class Actions*, 57 Vand. L. Rev. 1797, 1827-28 (2004).

In these "merger objection" cases, the stockholder plaintiff generally alleges that the seller's board of directors sold the company for a price that was too low and through a sales process that was unfair in some way. *See* Browning Jeffries, *The Plaintiffs' Lawyer's Transaction Tax: The New Cost of Doing Business in Public Company Deals*, 11 Berkeley Bus. L.J. 55, 56-57, 68 (2014). Once the seller files the required public disclosures (*e.g.*, a proxy statement or tender offer recommendation), the stockholder plaintiff alleges that the disclosures are false and misleading with respect to the background or terms of the transaction. *See* Jill E. Fisch et al., *Confronting the Peppercorn Settlement in Merger Litigation: An Empirical Analysis and A Proposal for Reform*, 93 Tex. L. Rev. 557, 565 (2015).

In a typical case, the stockholder plaintiff immediately files a motion for a temporary restraining order and a preliminary injunction, arguing that the court should enjoin the closing of the transaction until the disclosure document is corrected or supplemented. After creating the risk that a transformative bet-the-company transaction might be enjoined, the stockholder plaintiff takes advantage of that risk by making an offer to settle with the merger parties. The standard proposal is

for a "disclosure-only" settlement: if the defendants make certain supplemental disclosures and pay plaintiffs' counsel a substantial fee award, plaintiffs will provide defendants with a broad release covering alleged misconduct in connection with the challenged transaction. The stockholder class receives only the supplemental disclosures. As the Seventh Circuit has observed, such a "class action that yields fees for class counsel and nothing for the class" is "no better than a racket." *In re Walgreen Co. Stockholder Litig.*, 832 F.3d 718, 724 (7th Cir. 2016).

Such offers are nevertheless difficult for the merger parties to refuse. Faced with the uncertainty, expense, and distraction of litigation, and the risk (however small) that a court might enjoin a critical corporate transaction on the basis of an expedited litigation record, many defendants choose to settle even meritless "merger objection" cases. *See* Fisch et al., *supra*, at 565-66; Matthew D. Cain & Steven Davidoff Solomon, *A Great Game: The Dynamics of State Competition and Litigation*, 100 Iowa L. Rev. 465, 478 (2015) ("Settlements which only require disclosure constitute 55.1% of the settlement types in the sample and are the most common type of settlement.").

The attorneys' fees associated with these "disclosure only" settlements have reached into the millions of dollars. *See* Cain et al., *supra*, at 624. Able to obtain large fees for little work, the plaintiffs' bar has made the filing of "merger objection" lawsuits increasingly routine. In 2008, approximately 54% of all public M&A deals were challenged. *See* Cornerstone Research, *Shareholder Litigation Involving Acquisitions of Public Companies: Review of 2017 M&A Litigation* (2018)

at 2, https://www.cornerstone.com/Publications/Reports/Shareholder-Litigation-Involving-Acquisitions-of-Public-Companies-Review-of-2017-M-and-A-Litigation (hereinafter "2017 Cornerstone Review"). This number rose sharply to 86% in 2009, and continued to rise until its peak of 94% in 2013. *See id.* The percentage of deals subject to suit hovered between 85% and 90% through 2015. *See id.*

These "merger objection" lawsuits are so common that they are viewed as a "merger tax" and part of the cost of doing M&A transactions. *See* Jeffries, *supra*, at 108 ("Through this overabundance of litigation, plaintiffs' attorneys have successfully attached what amounts to a transaction tax to an overwhelming majority of large public company deals. Attorneys extort this tax – in the form of attorneys' fees – from defendant companies who fear their deals will die after being tied up in lengthy, often frivolous litigation.").

A. *Trulia* Eliminates Delaware as a Friendly Forum for Merger Objection Suits.

Prior to 2016, the majority of these abusive "merger objection" suits were filed in Delaware pursuant to the "internal affairs doctrine." Over time, Delaware courts expressed increasing skepticism of "merger objection" cases generally and "disclosure-only" settlements in particular. *See Assad v. World Energy Sols., Inc.*, No. 10324-CB (Del. Ch. Aug. 20, 2015) ("It just can't be that there are meaningful disclosure violations in every single M&A case that's being filed in this court."); *see also In re Aruba Networks, Inc. Stockholders Litig.*, No. 10765-VCL (Del. Ch. Oct. 9, 2015) ("[W]e have

reached a point where we have . . . a real systemic problem."); *In re Riverbed Tech., Inc. Stockholders Litig.*, No. 10484-VCG (Del Ch. July 27, 2015) ("[A]t least some members of this Court have been thinking in some depth about what the value of disclosure-only settlements is.").

The primary reason for the Delaware courts' skepticism was that the supplemental disclosures in many cases addressed immaterial details that did not aid stockholders in deciding whether to approve a transaction. *See In re Aruba Networks*, No. 10765-VCL; *Assad*, No. 10324-CB; *In re Riverbed Tech.*, No. 10484-VCG; *Acevedo v. Aeroflex Holding Corp.*, No. 7930-VCL. (Del. Ch. July 8, 2015).

In *Trulia*, the Delaware Chancery Court largely eliminated "disclosure-only" settlements in order to reduce frivolous "merger objection" litigation. The *Trulia* court emphasized that:

> [s]cholars have criticized disclosure settlements, arguing that non-material supplemental disclosures provide no benefit to stockholders and amount to little more than deal "rents" or "taxes," while the liability releases that accompany settlements threaten the loss of potentially valuable claims related to the transaction in question or other matters falling within the literal scope of overly broad releases.

129 A.3d at 887.

Accordingly, the Chancery Court rejected the parties' "disclosure-only" settlement, finding that the supplemental disclosures that plaintiffs' attorneys obtained for the class were not "material or even helpful." *Id.* The Chancery Court made clear that

going forward, it would approve disclosure-only settlements only where "the supplemental disclosures address a plainly material misrepresentation or omission."

B. The Plaintiffs' Bar Shifts Merger Objection Suits to Federal Court.

The *Trulia* decision had an immediate impact on the plaintiffs' bar's tactics in "merger objection" litigation.[7] Since *Trulia*, the plaintiffs' bar has redirected "merger objection" litigation to federal courts. The post-*Trulia* transfer of "merger objection" litigation to federal courts has been immediate and substantial. In 2014, the federal courts saw 40 "merger objection" filings. *See* NERA, *Recent Trends in Securities Class Action Litigation: 2018 Full-Year Review* (Jan. 29, 2019) at 5, https://www.nera.com/content/dam/nera/publications/2019/PUB_Year_End_Trends_012819_Final.pdf (hereinafter "2018 NERA Review"). In 2015, that number rose to 42 "merger objection" filings. *Id.* In 2016, the federal courts saw more "merger objection" filings than the past two years combined, with 92 "merger objection" suits filed. *See id.* That number more than doubled in 2017, reaching 204 federal court "merger objection" suits. *See id.* That high level was sustained in 2018, with 210 "merger objection" suits filed. *See id.* The number of "merger objection" filings in federal courts in 2017 and 2018 is more than the number of filings in the years 2009 through 2015 combined. *See id.*

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[7] The number of challenged mergers dropped from 84% in 2015 to 71% in 2016 and 73% in 2017. *See* 2017 Cornerstone Review, *supra*, at 2.

This increase in federal filings corresponds to a decrease in "merger objection" lawsuits filed in Delaware. Pre-*Trulia*, when suing a company incorporated in Delaware, stockholders filed 60% of suits in Delaware. *See* NERA, "Recent Trends in Securities Class Action Litigation: 2016 Full-Year Review" (Jan. 23, 2017) (citing Matthew D. Cain and Steven Davidoff Solomon, *Takeover Litigation in 2015*, Berkeley Cent. for L. Bus. Econ. (Jan. 14, 2016), https://ssrn.com/abstract=2715890). That number dropped to 23% in 2016 and to just 6% in 2017. *See* 2017 Cornerstone Review, *supra*, at 5.

Experts project that this trend will continue. 210 of the 441 securities class action filings in 2018 were "merger objection" cases in federal court. *See* 2018 NERA Review, *supra*, at 5.

The plaintiffs' bar has turned to federal courts in the hope that those courts would be willing to approve the type of disclosure-only settlements rejected in *Trulia*. *See Rosenfeld v. Time Inc.*, No. 17CV9886 (DLC), 2018 WL 4177938, at *2 (S.D.N.Y. Aug. 30, 2018) ("Post-*Trulia*, plaintiffs have begun bringing M&A lawsuits in other courts, particularly federal courts."). Plaintiffs have had mixed results, with some courts following *Trulia* and others willing to approve disclosure-only settlements. *Compare In re Walgreen Co. Stockholder Litig.*, 832 F.3d at 724-26 (adopting the rationale of *Trulia*), *with In re Hatteras Fin., Inc., S'holder Litig.*, 286 F. Supp. 3d 727, 730-31 (M.D.N.C. 2017) (approving settlement despite finding that supplemental disclosures were immaterial).

C. The Plaintiffs' Bar Forum Shops Within the Federal Court System.

Decisions by federal courts have had immediate impacts on "merger objection" litigation. For instance, the number of "merger objection" suits filed in the Seventh Circuit dropped by 60% within a year following its disapproval of disclosure-only settlements in *In re Walgreen Co. Stockholder Litigation*. 2018 NERA Review, *supra*, at 5.

Even prior to the Ninth Circuit's decision below, plaintiffs were flocking to the Ninth Circuit in disproportionate numbers. Although 50% of all U.S. corporations and over 67% of all Fortune 500 companies are incorporated in Delaware,[8] in 2017, only 20% of all federal-court challenges to M&A deals were filed in the Third Circuit; in 2018, less than 35% of all challenges were in the Third Circuit. *See* Cornerstone Research, *Securities Class Action Filings: 2018 Year in Review* (Jan. 30, 2019) at 14,https://www.cornerstone.com/Publications/Reports/Securities-Class-Action-Filings-2018-Year-in-Review. This mismatch reflects a distinct pivot to courts in the Ninth Circuit. In the three-year period from 2012 through 2014, only two "merger objection" suits were filed annually in district courts in that circuit; only eight cases were filed there in 2015. *Id.* However, in 2016, 25 such cases were filed in district courts in the Ninth Circuit, a figure which increased to 41 cases in 2017. *Id.* Thirty-three cases were filed in the Ninth Circuit in 2018. *Id.*

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[8] *Annual Report Statistics*, Del. Division of Corps., https://corp.delaware.gov/stats/ (last visited Feb. 26, 2019).

The shift in where plaintiffs file their suits even within the federal court system demonstrates that the plaintiffs' bar reacts to the perceived friendliness of courts to their "merger objection" suits. If this Court adopts the Ninth Circuit's negligence standard, plaintiffs will almost certainly abandon state court litigation and instead file nearly all "merger objection" cases in federal courts.

* * *

In the event the Court upholds the existence of an implied private right of action under § 14(e), the Court should adopt a scienter standard because negligence will burden the federal court system with an increasing number of frivolous "merger objection" cases that the plaintiffs-side class action bar continues to file without any concomitant benefit to corporations and society.

III. OTHER POLICY CONSIDERATIONS STRONGLY FAVOR A SCIENTER STANDARD FOR § 14(e) CLAIMS.

A. A Negligence Standard for § 14(e) Increases the Risk of Over-Disclosure.

In addition to inviting more "merger objection" cases into federal courts, a negligence standard for § 14(e) will change the type and volume of disclosures corporations make in connection with tender offers. The Exchange Act was intended to increase disclosure from companies to investors, "arming investors with information" in order to improve market efficiency, curb corporate abuse, limit insider trading, and reduce the need for government intervention. Troy A. Paredes, *Blinded by the Light: Information Overload and Its Consequences for Securities Regulation*, 81 Wash. U.

L.Q. 417, 418 (2003); *see also Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 195 (1976); Thomas L. Hazen, *Treatise on the Law of Securities Regulation* § 1:16 (7th ed. 2017). Section 14(e), enacted in 1968 as part of the Williams Act (amending the Exchange Act), serves this goal as well. *See* Pub. L. No. 90-439, 82 Stat. 455; *see also Schreiber*, 472 U.S. at 11 ("Nowhere in the legislative history is there the slightest suggestion that § 14(e) serves any purpose other than disclosure . . . .").

The Exchange Act and the Williams Act amendments, of course, do not require disclosure to shareholders of every fact. Rather, the statute and this Court have required disclosure of only material information. *See TSC Indus., Inc. v. Northway, Inc.*, 426 U.S. 438, 448 (1976). In the tender offer context, federal courts find "a misstatement or omission [to be] 'material if there is a substantial likelihood that a reasonable shareholder would consider it important in deciding' whether to accept the tender offer." *Seaboard World Airlines v. Tiger Int'l, Inc.*, 600 F.2d 355, 361 (2d Cir. 1979) (quoting *Prudent Real Estate Tr. v. Johncamp Realty, Inc.*, 599 F.2d 1140, 1146 (2d Cir. 1979) (Friendly, J.)) (additional quotation marks omitted); *accord In re Digital Island Sec. Litig.*, 357 F.3d at 328. This is essentially the same standard that this Court announced in *TSC Industries*, and which federal courts apply to § 10(b) cases. *TSC Indus.*, 426 U.S. at 448.

In recent years, however, attempts to comply with these disclosure requirements in the context of an aggressive litigation environment have created a risk of "over-disclosure," as management teams are

incentivized to "bury shareholders in an avalanche of trivial information,"[9] in order to minimize risk and "avoid liability." *In re Goodyear Tire & Rubber Co. Sec. Litig.*, 1993 WL 130381, at *6. This practice of over-disclosure is not "conducive to informed decision-making." *TSC Indus.*, 426 U.S. at 448-49. Over-disclosure causes companies to waste resources by disclosing immaterial information, which in turn causes investors to waste their time, money, and effort attempting to distill the material from the immaterial in disclosure documents that are often hundreds of pages long. *See* Geoffrey A. Manne, *The Hydraulic Theory of Disclosure Regulation and Other Costs of Disclosure*, 58 Ala. L. Rev. 473, 507 (2007).

A negligence standard encourages over-disclosure. Instead of making judgments to ensure that no material misstatements or omissions appear in the documents, companies will have every reason to attempt to avoid liability under a negligence standard by erring in favor of over-inclusive disclosures. A negligence standard thus upsets the balance struck by this Court's jurisprudence, which seeks to ensure that shareholders obtain material information without being drowned in a sea of mundane, immaterial details.

This Court has recognized the danger of over-disclosure. *See TSC Indus.*, 426 U.S. at 448 ("Some information is of such dubious significance that insistence on its disclosure may accomplish more harm than good.").[10] Here, a negligence standard

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[9] *TSC Indus.*, 426 U.S. at 448.

[10] Delaware courts, too, have cautioned against over-disclosure. *See In re Micromet Inc. S'holders Litig.*, C.A. No.

tips the materiality bar too far in one direction – the wrong direction – and invites management to make voluminous tender offer documents even longer, without providing any additional material information to shareholders. If a negligence standard is adopted, the issue of over-disclosure is likely to affect all future tender offers.

B. A Negligence Standard for § 14(e) Violations Will Chill Tender Offers.

As noted above, § 14(e) was added to the Exchange Act as part of the amendments contained in the Williams Act, enacted in 1968. In the 1960s, tender offers grew in popularity and were not otherwise regulated by the SEC. S. Rep. No. 90-550, at 2 (1967) (noting that "[t]he cash tender offer has become an increasingly favored method of acquiring control of publicly held corporations"). While Congress sought to regulate tender offers through the Williams Act amendments to the Exchange Act in order to avoid potential abuses, *id.* at 2-3, its intent was to avoid discouraging tender offers

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7197-VCP, 2012 WL 681785, at *11 (Del. Ch. Feb. 29, 2012) ("The duty to disclose is not a mandate for prolixity. Instead, balanced against the requirement of complete disclosure is the pragmatic consideration that creating a lenient standard for materiality poses the risk that the corporation will bury the shareholders in an avalanche of trivial information, a result that is hardly conducive to informed decision-making.") (internal citations, quotation marks, and alterations omitted); *Arnold v. Soc'y for Sav. Bancorp, Inc.*, 650 A.2d 1270, 1280 (Del. 1994) ("Delaware law does not require disclosure of inherently unreliable or speculative information which would tend to confuse stockholders or inundate them with an overload of information.").

because it viewed them as useful in providing a check on inefficient management:

> It was strongly urged during the hearings that takeover bids should not be discouraged because they serve a useful purpose in providing a check on entrenched but inefficient management. It was also recognized that these bids are made for many other reasons, and do not always reflect a desire to improve the management of the company. The committee has taken extreme care to avoid tipping the balance of regulation either in favor of management or in favor of the person making the takeover bid. The bill is designed to require full and fair disclosure for the benefit of investors while at the same time providing the offeror and management equal opportunity to fairly present their case.

Id. at 2-4.

Tender offers continue to prove beneficial to the market today. Originally, tender offers were often used in connection with a hostile takeover or to circumvent a board of directors that was unwilling to entertain a merger offer. In the late 1980s, the SEC enacted the "Best Price Rule," which required, among other things, that all shareholders, whether owning a single share or owning a large block, were paid the same price. *See* 17 C.F.R. § 240.14d-10 (2019). This made tender offers fairer and nearly eliminated their use in hostile takeovers.

Today, companies seeking a business combination may prefer tender offers for a variety of reasons. For example, tender offers are often faster to complete than mergers due to less onerous public filing

requirements, faster antitrust review, and SEC rules requiring a bidder to pay for shares within three days, or else return those shares to the shareholders. *See* David Offenberg & Christo Pirinsky, *How Do Acquirers Choose between Mergers and Tender Offers?*, 116 J. Fin. Econ. 331, 340-42 (2015). Based on empirical analysis, tender offers are often complete one to two months faster than mergers. *See id.* at 340.

Tender offers also can be more beneficial than mergers for shareholders. As noted above, shareholders are paid quickly for their shares due to SEC requirements that funding for a tender offer be in place before the tender offer begins and that shareholders be paid (or have their shares returned) within three days of the close of the tender offer. *See id.* at 33; *see also* 17 C.F.R. § 240.14d-1(c) (2019); 17 C.F.R. § 240.14e-8(c) (2019). In addition, tender offers are associated with higher premiums than mergers. *See* Offenberg & Pirinsky, *supra*, at 342-43.

Imposing a negligence standard for violations of § 14(e) risks chilling tender offer activity. Parties interested in a tender offer transaction in order to capture the numerous benefits, including those discussed above, may be deterred from pursuing a tender offer if they will be liable to potential shareholders based on mere negligence.[11] As a

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[11] This key difference between tender offers and mergers – that tender offers often involve representations by third parties to shareholders whereas mergers involve representations by management to shareholders – provides one possible reason for adopting a higher standard for § 14(e) violations than for § 14(a) violations. Note, however, that while several lower courts have

result, shareholders will lose a meaningful check on inefficient but entrenched management, and corporations will lose an efficient way to effect a business transaction.

C. A Negligence Standard for § 14(e) Undercuts Settled Mergers and Acquisitions Law.

The adoption of a negligence standard adversely affects financial institutions participating in merger activity. Financial institutions are often involved in merger activity as advisors. In most mergers, the seller obtains a "fairness opinion" from a financial advisor, which provides the financial advisor's view on whether the price terms of the merger – usually the per share price to be received by the seller's shareholders – are fair.

As the facts of this case illustrate, shareholders often challenge the financial advisor's analyses. *See* Pet. App. at 4a-5a. Respondent Varjabedian challenged, among other things, the Recommendation Statement's failure to summarize Goldman Sachs' Premium Analysis conducted in connection with the Avago-Emulex merger. Pet. App. 5a-6a.

Under Delaware law, a seller must disclose only a "fair summary" of the fairness opinion. *See, e.g.*, *Dent v. Ramtron Int'l Corp.*, C.A. No. 7950-VCP,

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adopted a negligence standard for § 14(a) claims, this Court has twice declined to decide the issue and the Sixth Circuit has affirmatively held that scienter is required. *See Mills v. Electric Auto-Lite Co.*, 396 U.S. 375 (1970); *TSC Indus., Inc. v. Northway, Inc.*, 426 U.S. 438 (1976); *see also, e.g.*, *Adams*, 623 F.2d at 423 & n.2.

2014 WL 2931180, at *12 (Del. Ch. June 30, 2014). Stockholder plaintiffs, however, routinely bring "merger objection" cases premised on the notion that merger parties failed to disclose every conceivable detail regarding the financial advisor's fairness opinion. Although Delaware courts have long rejected these claims as a matter of state law,[12] negligence-based § 14(e) claims give plaintiffs the potential opportunity to do what Delaware has prohibited – nitpick the details and assumptions underlying financial analyses.

Moreover, the lower standard may entice stockholder plaintiffs to allege § 14(e) claims directly against financial advisors. Plaintiffs sometimes allege aiding and abetting claims against a financial advisor, but such claims often fail (or are not made) because they require scienter. *See, e.g.*, *In re Zale Corp. Stockholders Litig.*, C.A. No. 9388-VCP, 2015 WL 6551418 (Del. Ch. Oct. 29, 2015) (dismissing aiding and abetting claim against financial advisor Merrill Lynch); *Malpiede v. Townson*, 780 A.2d 1075, 1098 (Del. Ch. 2001) ("[P]laintiffs' aiding and abetting claim fails as a matter of law because the allegations in the complaint do not support an

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[12] *See, e.g.*, *Dent*, 2014 WL 2931180, at *13 ("This is simply a 'tell me more' request that, unlike a viable disclosure claim, fails to identify how the analysis is misleading or incomplete if it does not disclose specifically which publicly available sources of information Needham used to do its work."); *In re 3Com S'holders Litig.*, Civil Action No. 5067-CC, 2009 WL 5173804, at *6 (Del. Ch. Dec. 18, 2009) ("There are limitless opportunities for disagreement . . . . Considering this reality, quibbles with a financial advisor's work simply cannot be the basis of a disclosure claim.").

inference that [defendant] knowingly participated . . . ."); *Lee v. Pincus*, C.A. No. 8458-CB, 2014 WL 6066108, at *13 (Del. Ch. Nov. 14, 2014) ("To demonstrate the 'knowing participation' element of an aiding and abetting claim, it must be reasonably conceivable from the well-pled allegations that 'the third party act[ed] with . . . knowledge . . . .' Knowing participation has been described as a 'stringent' standard that 'turn[s] on proof of scienter.'") (alterations in original; internal citations omitted).

A negligence standard opens the door to claims that would have failed under Delaware law, as plaintiffs need only allege negligence, not scienter, to assert § 14(e) claims directly against financial advisors. This Court has long rejected aiding and abetting claims for violations of the securities laws.[13] *See Stoneridge Inv. Partners, LLC v. Scientific-Atlanta, Inc.*, 552 U.S. 148, 158 (2008) (holding the reforms of the PSLRA do not permit private aiding

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[13] This Court's decision in *Janus Capital Group, Inc. v. First Derivative Traders*, 564 U.S. 135 (2011), requires that a defendant be the "maker" of a statement in order to be the target of a federal securities claim. *Janus* and its progeny bar § 14(e) claims against financial advisors and other third parties. The transition of "merger objection" litigation to federal court is a relatively new, post-*Trulia* phenomenon, however, and it will take time to § 14(e) case law to catch up with more settled § 10(b) law. Further, at least one court – the United States District Court for the Northern District of California – has found that alleged misrepresentations in a recommendation statement that relate to a fairness opinion are attributable to the financial advisor. *See Biotechnology Value Fund, L.P. v. Celera Corp.*, No. C 13-03248 WHA, 2014 WL 988913, at *3-4 (N.D. Cal. Mar. 10, 2014).

and abetting claims under § 10(b)); *Cent. Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A.*, 511 U.S. 164, 183 (1994) (holding that private plaintiffs cannot maintain aiding and abetting claims under § 10(b)). The adoption of a negligence standard conflicts with this Court's jurisprudence, which establishes that there should be no private civil aiding and abetting liability under the securities laws. For that reason, this Court should reverse the Ninth Circuit's erroneous decision and adopt a scienter standard for § 14(e) claims.

CONCLUSION

For the reasons discussed above, this Court should reverse the Ninth Circuit's opinion and adopt a scienter standard for violations of § 14(e).

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